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Supreme Court of the United States

October Term, 1944.

No. 1187

HARRY E. KALODNER, Judge of the District Court of the United States for the Eastern District of Pennsylvania,

Petitioner,

vs.

WEBSTER EISENLOHR, INC.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT AND BRIEF IN SUPPORT THEREOF AND APPENDIX.

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SUPREME COURT OF THE UNITED STATES.

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No.

HARRY E. KALODNER, Judge of the District Court of the United States for the Eastern District of Pennsylvania,

Petitioner,

vs.

WEBSTER EISENLOHR, INC.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT.

TO THE HONORABLE, THE CHIEF JUSTICE AND ASSOCIATE JUSTICES OF THE SUPREME COURT OF THE UNITED STATES:

Your petitioner, Harry E. Kalodner, Judge of the District Court of the United States for the Eastern District of Pennsylvania, by his attorney, respectfully prays that a Writ of Certiorari issue to review the judgment, order and peremptory writ of mandamus of the United States Circuit Court of Appeals for the Third Circuit in the above entitled case, ordering, requiring, and commanding the

petitioner to vacate, revoke, set aside and declare null and void and of no effect an order of June 9, 1943 entered in an action pending in the petitioner's court by Andrew J. Speese, 3rd, as plaintiff against Webster Eisenlohr, Inc. as defendant, Civil Action No. 2941 in the District Court of the United States for the Eastern District of Pennsylvania, in which said order the petitioner appointed one David Bortin special master to investigate, take testimony and report to the court.

STATEMENT OF MATTER INVOLVED.

This case involves

(a) the question whether a District Judge's interlocutory and discretionary reference to a master in a spurious class suit, praying inter alia for the appointment of a receiver, wherein a compromise of the suit was reached between the defendant on one hand and the plaintiff and others in his class on the other hand, may be controlled or reviewed by mandamus in the Circuit Court, and

(b) whether such order was not proper under the provisions of Rule 23(c) of the Federal Rules of Civil Procedure, which provides that no compromise in a class action may be reached without approval of the Court; and because of the prayer for the appointment of a receiver and the allegations of fraud in the complaint.

THE ESSENTIAL FACTS.

(Note: For purposes of clarity, Harry E. Kalodner, the petitioner in this Court, respondent in the Circuit Court,

and Trial Judge in the District Court, will sometimes hereinafter be referred to as "Trial Judge"; and Webster Eisenlohr, Inc., defendant in the District Court, petitioner in the Circuit Court, and respondent in this Court, will sometimes hereinafter be referred to as "Eisenlohr".)

Eisenlohr, while defendant in a litigation in the District Court for the Eastern District of Pennsylvania, filed its petition (R. 1-42) in the Circuit Court of Appeals for the Third Circuit, praying that the Circuit Court grant a writ of mandamus directed to the Honorable Harry E. Kalodner, Judge of the said District Court, requiring and commanding him to vacate an order of June 9, 1943, referring certain issues to a Special Master (R. 11). Upon this petition, the Circuit Court issued a rule to show cause why the petition for mandamus should not be granted (R. 103).

The plaintiff in the District Court had filed a complaint in a civil action for himself and others in the same class against Eisenlohr as defendant (R. 15-20). The complaint alleged that

(a) The defendant was a corporation (R. 15).

(b) Two classes of stock had been issued: some 4090 shares of common and 5037 shares of preferred (R. 16).

(c) Plaintiff was a preferred stockholder (R. 15).

(d) Annual dividends on the preferred were $7.00 per share (R. 16).

(e) Two quarterly dividends on the preferred had been passed (R. 16).

(f) By virtue of the provisions of the by-laws, the preferred stockholders were in consequence entitled to exclusive voting power (R. 16-17).

(g) This exclusive voting power had been denied holders of the preferred stock (R. 18).

(h) Dividends on preferred stock had remained unpaid since April of 1931, and as of December 31, 1941, amounted to $75.25 per share (R. 16).

(i) The defendant company was dominated and controlled by the Chase National Bank of New York through its ownership of a large block of the common stock (R. 18).

(j) The control and management of the company was being usurped by alleged officers and directors by the illegal action of the company in denying exclusive voting power to the preferred stock (R. 19).

(k) The usurpation was in fraud of the rights and privileges of the preferred stockholders (R. 19).

(l) The assets and management of the company were being managed, controlled and disposed of for the sole benefit of the holders of the common stock to the injury and prejudice of the preferred stockholders (R. 19).

The complaint prayed for special relief granting exclusive voting power to the preferred stockholders, for the appointment of a receiver, and for general relief (R. 19-20).

The defendant Eisenlohr filed an answer admitting the passing of the dividends (R. 22), but denying other material allegations of the complaint, and challenging the plaintiff's construction of the by-laws concerning the vesting of exclusive voting power in the preferred stock, after the passing of two dividends (R. 24).

Several hearings were held before the Court. Both parties were represented by counsel. In the course of the hearings certain facts transpired through the medium of admissions by counsel for both parties, and submission of various documents and letters to the Court by counsel for the defendant. One other fact came to light by virtue of published notices of the Securities and Exchange Commission.

These developments were:

(a) On March 23, 1943, subsequent to the institution of this litigation, the defendant company sent to stock-

holders, including holders of the preferred, copies of the company's annual report for 1942 (R. 4).

(b) The following appeared on Page 1 of the report:

"The net profit from operations for the calendar year amounted to $405,451.73 before provision for Federal Income Taxes, and to $235,751.73 after deduction of $169,700 as the estimated amount required for such taxes, as compared with $192,595.24 for the preceding calendar year in which no provision for Federal Income Taxes was considered necessary or made. This was equivalent to 49¢ per share on the common stock for 1942, after deduction of the estimated amount required for such taxes *and after allowance for unpaid preferred dividends accrued in said year*, as compared with 38¢ per share for the preceding year 1941." (Italics supplied) (R. 27).

(c) Preferred stock called for redemption was entitled to be paid for at the rate of $115.00 per share, plus accumulated dividends, or $197.25 per share (R. 31).

(d) Upon liquidation preferred stock was entitled to be paid for at the rate of par plus accumulated arrearages of dividends ($182.25) before common stock could participate (R. 24).

(e) Under date of March 26, 1943, the Company caused letters to be sent to all preferred stockholders offering to purchase the preferred stock at $150.00 per share flat (R. 4).

(f) There was no disclosure (in connection with the offer of purchase) that accumulated arrearages of dividends on the preferred stock ($82.25 per share) must be paid before dividends could be declared on common stock (R. 34, 49-50, 106).

(g) There was no disclosure (in connection with the offer of purchase) as to the amounts to be paid for preferred stock on liquidation or redemption (R. 34, 49-50, 106).

(h) The earnings for the first quarter of 1943 amounted to $26.00 per share on the preferred stock. There was no disclosure of this fact to the holders of preferred stock (R. 34, 52, 54, 58, 106).

(i) Those in management or control of the company sent to counsel for the complainant a list of holders of shares of preferred stock and offered to pay said counsel the sum of $7.50 per share (equivalent to $750.00 per hundred share certificate) as a brokerage commission for all shares which he assisted the company to purchase from preferred stockholders. This fact was not disclosed to preferred stockholders (R. 34, 112, 106-7, 136).

(j) Those in management or control of the company agreed in addition to pay a brokerage fee of $10,000.00 to a brokerage firm for procuring the sale of stock from preferred stockholders in general at the price of $150.00 per share flat. This fact was not disclosed to the preferred stockholders (R. 111, 34, 107, 136).

(k) Securities Exchange reports published in the newspapers showed that Everett Meyer, president and director of the defendant company, had purchased 4700 shares of common stock of the defendant company in May, 1943 (R. 106).

Certain other facts transpired partly at the hearings and partly at the reargument before the Court below. They were:

Prior to the hearing of May 24, 1943 before the District Court, Eisenlohr had purchased the stock of Speese, plaintiff in the District Court, and of other stockholders represented by Speese's counsel (R. 4, 75). Only a few stockholders remained who had not sold their preferred stock to the company (R. 75). Counsel for plaintiff several times referred to the transactions as a "settlement" of the litigation (R. 75).

4047 shares of the preferred stock outstanding had been purchased by Eisenlohr for $150.00 flat per share: 990

shares were still outstanding on or about June 7, 1943 (R. 5, 35).

Subsequently and prior to rehearing in the Circuit Court Eisenlohr redeemed all preferred stock not theretofore purchased by it as authorized by the charter (presumably at $197.25 per share) (R. 136).

On June 9, 1943 the Trial Judge entered an order of reference to David Bortin, Esq., a member of the Philadelphia Bar, as Special Master, with the duty and authority to investigate the acts, conduct, property, liabilities, financial condition, books, records and assets of Eisenlohr: the circumstances relating to the offer of March 26, 1943 to the holders of 7% cumulative approved stock of the defendant, and other acts of the parties: the question whether there had been any violation of Rule X-10B-5 "Employment of Manipulative and Deceptive Devices" of the Securities and Exchange Commission: to take testimony and report to the Court (R. 13-15).

Eisehlohr then filed its petition in the Circuit Court of Appeals for the Third Circuit praying that a writ of mandamus be directed to the Trial Judge and to the other Judges of the Court requiring them to vacate the order (R. 1-42). After argument before the full court (five Judges) the said Circuit Court, on September 27, 1944, filed an opinion holding that the order of reference complained of should be set aside, but refrained from ordering the formal issuing of a writ of mandamus prayed for on the ground that it was unlikely that such action would be necessary (R. 127). Biggs, J. filed a dissenting opinion in which McLaughlin, J. concurred (R. 128-140).

Under date of November 13, 1944 the Trial Judge entered an order amending his order of June 9, 1943 (the order of reference under attack), the amendment consisting of striking out that portion of the order which made it the duty and power of the Special Master to investigate the question as to whether or not there had been any violation of Rule X-10B-5 of the Securities and Exchange Commission (App., p. 1).

Under date of January 23, 1945, the U. S. Circuit Court of Appeals for the Third Circuit caused a peremptory writ of mandamus to issue requiring the Trial Judge and the other Judges of the District Court to vacate, revoke, set aside, etc. the order of reference of June 9, 1943 (R. 141). This petition for certiorari followed.

Briefly stated, the majority opinion held that the matters referred to the Special Master were outside the scope of investigation of the Court and foreign to the litigation; and that Rule 23 (c) of the Federal Rules of Civil Procedure was not applicable. The dissenting Judges based their dissent upon the proposition that the order of reference was in aid of or ancillary to the original proceeding (R. 133); that the matters into which the Special Master was to inquire were ancillary to or closely connected with the issues in the pending case (R. 133); that a Judge of the District Court, sitting as chancellor, possesses power to investigate the circumstances under which parties to a pending litigation have compromised claims which were the subject matter of the suit pending (R. 134); and in general, that the order of reference was justified under Rule 23 (c), requiring the approval of the Court for a compromise in a class suit (R. 137).

The dissenting opinion also stated that if the Trial Judge has reason to believe that a compromise of the complainant's claims has been arrived at by fraud, by collusion, by deceit or by the withholding of pertinent information, he may not be accused of a breach of discretion if he investigates the circumstances of the compromise (R. 134); that a district court of the United States is empowered by Sec. 262 of the Judicial Code, 28 U.S.C.A. 377, to employ all writs necessary for the exercise of its jurisdiction in a pending cause; and that the Trial Judge in reality availed himself of the provisions of said section in making the order of reference complained of (R. 135).

JURISDICTION.

The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925 (43 Stat. 938, U.S.C. Title 28, Sec. 347). The judgment or order of the United States Circuit Court for the Third Circuit to be reviewed was entered January 23, 1945.

QUESTIONS INVOLVED.

1. Is not a District Judge's Order of reference to a Special Master, directing an inquiry into the circumstances surrounding an effectuated compromise of a class suit, interlocutory or discretionary in character, and such as may not be controlled or reviewed by a writ of mandamus in a Circuit Court?

2. Was not the order complained of proper in view of (a) the provisions of Rule 23 (c) of the Rules of Federal Procedure, and (b) the acts of the parties amounting to a compromise of the class litigation?

3. Was not the order complained of proper in view of the prayer for the appointment of a receiver and the allegations of fraud and domination in the complaint?

REASONS RELIED ON FOR ALLOWANCE OF WRIT.

1. In issuing a peremptory writ of mandamus requiring and commanding the Trial Judge and the other Judges of the Court to vacate, revoke and set aside, etc. the order of reference to a Special Master, the Circuit Court of Appeals for the Third Circuit has decided a federal question in a way probably in conflict with the following applicable decisions of the Supreme Court of the United States:

Ex parte Wagner, 249 U. S. 465; 39 S. Ct. 317; 63 L. Ed. 709;

American Construction Co. v. Jacksonville T. & K.W.R. Co., 148 U. S. 372; 13 Sup. Ct. 758; 37 L. Ed. 486;

U. S. ex rel. Alaska Smokeless Coal Co. v. Lane, 250 U. S. 549; 40 Sup. Ct. 33; 63 L. Ed. 1135.

2. In holding the order of reference to a Special Master improper, the Circuit Court of Appeals for the Third Circuit has decided an important question of federal law which has not been, but should be, settled by the Supreme Court of the United States, to wit: the question whether a District Court judge may under the provisions of Rule 23 (c) of the Federal Rules of Civil Procedure, direct a Special Master to make an inquiry into the facts and circumstances surrounding a compromise which has been actually effectuated in a class suit, without submission for approval to the Trial Judge, through the medium of the purchase by the defendant corporation of the stock interests of the plaintiff and others in the class in the corporation.

3. The Judges of the Circuit Court of Appeals for the Third Circuit divided 3 to 2 in their opinion.

WHEREFORE, your petitioner respectfully prays that a writ of certiorari be issued out of and under the seal of this Court, directed to the United States Circuit Court of Appeals for the Third Circuit, sitting at Philadelphia, Pennsylvania, commanding that Court to certify and to send to this Court on a day certain to be therein named a full and complete transcript of the record and all proceedings had in this case, numbered and entitled on its docket OCTOBER TERM, 1943, No. 8412, to the end that this case may be reviewed and determined by this Court; that the said judgment of the United States Circuit Court of Appeals for the Third Circuit may be reversed by this Court; and that your petitioner may have such other and further relief in the premises as may seem just and proper.

And your petitioner will ever pray.

HIRSH W. STALBERG,
Attorney for Petitioner.